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FENNEMORE CRAIG, P.C.
Norman D. James (No. 006901)
3003 North Central Avenue
Suite 2600
Phoenix, Arizona 85012
Telephone (602) 916-5000
Attorneys for DMB White Tank, LLC

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION
OF ARIZONA-AMERICAN WATER
COMPANY, AN ARIZONA CORPORATION,
FOR A DETERMINATION OF THE
CURRENT FAIR VALUE OF ITS UTILITY
PLANT AND PROPERTY AND FOR
INCREASES IN ITS RATES AND CHARGES
BASED THEREON FOR UTILITY SERVICE
BY ITS ANTHEM WATER DISTRICT AND
ITS SUN CITY WATER DISTRICT, AND
POSSIBLE RATE CONSOLIDATION FOR
ALL OF ARIZONA-AMERICAN
COMPANY'S DISTRICTS.

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION
OF ARIZONA-AMERICAN WATER
COMPANY, AN ARIZONA CORPORATION,
FOR A DETERMINATION OF THE
CURRENT FAIR VALUE OF ITS UTILITY
PLANT AND PROPERTY AND FOR
INCREASES IN ITS RATES AND CHARGES
BASED THEREON FOR UTILITY SERVICE
BY ITS ANTHEM/AGUA FRIA
WASTEWATER DISTRICT, ITS SUN CITY
WASTEWATER DISTRICT AND ITS SUN
CITY WEST WASTEWATER DISTRICT,
AND POSSIBLE RATE CONSOLIDATION
FOR ALL OF ARIZONA-AMERICAN
COMPANY'S DISTRICTS.

DOCKET NO. SW-01303A-09-0343

**DMB WHITE TANK, LLC'S
CLOSING BRIEF**

DMB White Tank, LLC ("DMB") hereby submits its closing brief in the above-entitled matter. DMB's primary concern is the excessive rate charged by Arizona-American Water Company ("AAWC" or "the Company") for sewage effluent. AAWC's Anthem/Agua Fria Wastewater District ("the Wastewater District"), which is responsible

1 for the treatment facilities that produce the effluent, has no rate for effluent in its tariff.
2 Instead, DMB was being billed at the rate of \$2.728 per 1,000 gallons for effluent, which
3 is over \$888 per acre-foot, by the Agua Fria Water District. Although that rate was
4 recently reduced by the Arizona Corporation Commission ("the Commission"),¹ the rate
5 for effluent exceeds the cost of using groundwater, and, as a result, DMB is now using
6 groundwater rather than effluent for turf irrigation and other non-potable uses.

7 To correct this anomalous situation, DMB asks, first, that the Commission establish
8 a specific rate for effluent produced by the Wastewater District. It makes no sense for the
9 Agua Fria Water District (which is not involved in this case) to be charging customers for
10 effluent resulting from the collection and treatment of wastewater by the Wastewater
11 District, utilizing the Wastewater District's plant and facilities. In effect, the Wastewater
12 District's sewer customers are subsidizing the cost of utility service by the Agua Fria
13 Water District. This situation is especially problematic because the sewer customers of
14 the Wastewater District differ from the water customers of the Agua Fria Water District.²

15 Second, DMB asks that the Commission set a rate for effluent that is reasonable
16 and encourages its reuse for turf irrigation consistent with Arizona water policy. DMB
17 submits that a rate of \$250 an acre-foot is appropriate and reasonable. As Mr. Kelly,
18 DMB's witness, explained, a rate of \$250 an acre-foot is consistent with the rate charged
19 by other private sewer companies regulated by the Commission, including the rate
20 charged by AAWC's Mohave Wastewater District. It also is slightly less than DMB's
21

22 ¹ On June 17, 2010, a procedural order was issued in Docket No. W-01303A-08-0227 reducing
23 the rate for non-potable water to \$1.24 per 1,000 gallons. That rate, which is equivalent to \$404
per acre-foot, is still substantially greater than DMB's cost to pump and transport groundwater,
which, as discussed below, is approximately \$250 an acre-foot. See Tr., Phase II, at 710.

24 ² Compare Hains Dt., Ex. DMH-4 (describing the Wastewater District) with Hains Dt., Ex. DMH-
25 1, filed on January 12, 2009, in Docket Nos. W-01303A-08-0227 and SW-01303A-08-0227
(describing the Agua Fria Water District). As detailed in Ms. Hains' reports, the Wastewater
26 District served about 5,000 customers during the 2008 test year, while the Agua Fria Water
District is much larger in geographic scope and served 33,000 customers.

1 cost to use groundwater, and thus will encourage the use of effluent for turf irrigation and
2 other non-potable uses rather than groundwater.

3 In addition, by encouraging the reuse of effluent, additional revenue will be
4 generated by the sale of effluent which will offset some of the costs incurred by the
5 Wastewater District to treat sewage and produce the effluent. This would benefit the
6 district's sewer customers by reducing their rates, while eliminating the subsidy that
7 currently exists. Thus, setting a price for effluent that is reasonable and encourages its use
8 will benefit everyone.

9 AAWC opposes this relief. Although its witness on this issue, Mr. Broderick,
10 testified that there should be a separate rate for the sale of effluent produced by the
11 Wastewater District, the Company disregarded Mr. Broderick's testimony and proposed
12 no rate for effluent in its final schedules filed on June 25. For the reasons set forth below,
13 the Company's position violates basic rate-making principles and public policy, and
14 therefore should be rejected. The Commission instead should authorize the Wastewater
15 District to charge \$250 per acre-foot for effluent that is produced and delivered by that
16 district's facilities.

17 **A. The Commission Should Establish a Rate for Sewage Effluent Produced**
18 **by the Wastewater District's Operations.**

19 DMB is the developer of a real estate project called Verrado, which is a master
20 planned community in the Town of Buckeye located north of Interstate 10 in the
21 southeastern foothills of the White Tank Mountains. Verrado contains approximately
22 8,800 acres of land. At present, approximately one-third of Verrado is built, including
23 3,000 improved lots with 1,600 homes, a commercial core area, two public schools, and
24 an 18-hole championship golf course called the Raven Golf Club.³

25 The Company provides water and sewer utility service to customers and

26 ³ Kelly Dt. at 3.

1 landowners in Verrado by means of two different utility “districts”: the Wastewater
2 District and the Agua Fria Water District.⁴ Among these services is the delivery of
3 sewage effluent, which is sold to DMB and reused for irrigation at the Raven Golf Club
4 pursuant to a reuse permit issued by the Arizona Department of Environmental Quality
5 (“ADEQ”).⁵ DMB also purchases effluent and other non-potable water for construction
6 purposes.⁶

7 The Wastewater District, however, does not have a rate for effluent and, therefore,
8 does not charge DMB for the effluent that it delivers. Instead, the Agua Fria Water
9 District charges DMB for the effluent produced by the Wastewater District.⁷ In Decision
10 No. 71410 (Dec. 8, 2009), the Agua Fria Water District’s rate for “non-potable water,”
11 which includes sewage effluent, was increased from \$202 per acre-foot (\$0.62 per 1,000
12 gallons) to more than \$888 per acre-foot (\$2.728 per 1,000 gallons) – an increase of 340
13 percent.⁸ The Wastewater District was not involved in that proceeding, nor is there any
14 indication in the record of that proceeding that the Commission understood that it was
15 establishing a rate for effluent produced and delivered by the Wastewater District.

16 As a result, the rate-making unit that owns and operates the wastewater collection
17 and treatment system does not collect any revenue from the byproduct of its operations.
18 Instead, a different rate-making unit collects all of the revenue associated with the
19 Wastewater District’s delivery of effluent, violating basic rate-making principles and
20 creating a mismatch between plant, operating and revenues.

21 The Staff engineer, Ms. Hains, performed the engineering analyses of the Agua
22

23 ⁴ See, e.g., Hains Dt., Ex. DMH-4; Hains Dt., Ex. DMH-1, filed on January 12, 2009, in Docket
Nos. W-01303A-08-0227 and SW-01303A-08-0227.

24 ⁵ Kelly Dt. at 2-3; Hains Dt., Ex. DMH-4 (Engineering Report for the Wastewater District).

25 ⁶ Kelly Dt. at 3.

26 ⁷ E.g., Tr., Phase II, at 184-85.

⁸ Id. at 8.

1 Fria Water District in the Company's prior rate case and the Wastewater District in the
2 current rate case.⁹ Ms. Hains' engineering report for the Agua Fria Water District
3 contains no discussion of any plant or expenses that relate to the production and delivery
4 of sewage effluent.¹⁰ During the hearing, Ms. Hains explained why effluent was not
5 mentioned in the engineering report for the water district:

6 Q. [by Mr. James] . . . Was effluent something that Staff
7 evaluated or that you evaluated, Ms. Hains, when you
8 did your engineering evaluation of the Agua Fria
9 Water District?

10 A. [by Ms. Hains] No. Effluent definition is treated
11 wastewater, and so because [its] wastewater, so it's for
12 this wastewater district. It's never belonged to the
13 Water District.

14 Q. So the plant that would be producing the effluent [and]
15 the cost associated with running that plant, that would
16 all be part of the Agua Fria Wastewater District;
17 correct?

18 A. Yes.¹¹

19 Ms. Hains also explained that wastewater is collected, treated at the Verrado wastewater
20 treatment plant, and then delivered to DMB's golf course for reuse purposes.¹² She also
21 discussed various permits needed to operate the wastewater treatment plant and properly
22 dispose of its effluent, as well as the testing costs incurred by the Company to ensure that
23 the effluent produced by the treatment plant meets applicable water quality standards.¹³

24 Ms. Hains' testimony is consistent with her engineering report for the Wastewater
25 District. Among other things, the engineering report states that "[f]inal treated effluent is
26

⁹ Tr., Phase I, at 784-86.

¹⁰ See generally Hains Dt., Ex. DMH-1, filed on January 12, 2009, in Docket Nos. W-01303A-08-0227 and SW-01303A-08-0227.

¹¹ Tr., Phase I, at 785-86.

¹² *Id.* at 775-76.

¹³ *Id.* at 778-80.

1 disposed on a golf course for irrigation use and ground water recharge” at Verrado.¹⁴ Ms.
2 Hains’ report also discusses compliance with the requirements of ADEQ and the
3 Maricopa County Environmental Services Department (“MCESD”), stating that the
4 Verrado wastewater system is “in full compliance for operation and maintenance, operator
5 certification and discharge permit limits.”¹⁵ The report also provides a “systematic flow
6 diagram” for the Verrado wastewater system which, among other things, depicts effluent
7 being delivered to the Raven Golf Club for reuse.¹⁶

8 In short, all of the facilities used to produce and deliver effluent in Verrado are, for
9 rate-making purposes, assigned to and operated by the Wastewater District. Furthermore,
10 the delivery of effluent to the Raven Golf Club for reuse is necessary for the Wastewater
11 District to dispose of the effluent in accordance with Arizona law and ADEQ and MCESD
12 requirements. Conversely, none of the plant and operating expenses related to the
13 production and delivery of effluent was assigned to the Agua Fria Water District for rate-
14 making purposes. Thus, that district’s rates for water service do not include a return on
15 any plant related to the production and delivery of effluent or the recovery of any
16 operating expenses incurred in connection with the production and delivery of effluent.

17 Allowing the Agua Fria Water District to bill customers for the delivery of effluent
18 therefore results in a mismatch between rate base, operating expenses and revenues. The
19 customers of the Wastewater District are subsidizing the customers of the Agua Fria
20 Water District, who pay less for water service due to the assignment of revenue from the
21 sale of effluent, lowering the Agua Fria Water District’s revenue requirement. There is no
22 evidence in the record justifying this revenue shift, nor is there any legal or regulatory
23 basis for shifting revenue from the Wastewater District and forcing customers of the
24

25 ¹⁴ Hains Dt. Ex. DMH-4 at 2.

26 ¹⁵ *Id.* at 6 (emphasis supplied)

¹⁶ *Id.* at 15, 16.

1 Wastewater District to pay higher rates to make up the difference.

2 With the exception of AAWC, none of the parties are advocating the continuation
3 of this subsidy, which is clearly unfair to the Wastewater District's customers. For
4 example, both Staff and the Residential Utility Consumer Office ("RUCO") agreed that
5 the Commission should establish a specific effluent rate in this case.¹⁷ In fact, AAWC's
6 witness on this issue, Mr. Broderick, testified that the Company is "okay" with
7 authorizing a rate for effluent, as long as the rate is "reasonable."¹⁸ The failure of AAWC
8 to propose a rate for effluent in its final schedules is therefore even more anomalous, as
9 Mr. Broderick was overruled after-the-fact by senior Company officials who apparently
10 want the subsidy to continue.

11 In sum, there is no legitimate basis for another AAWC district to be billing and
12 collecting revenue for a service being provided by the Wastewater District, and forcing
13 Wastewater District customers to pay higher rates as a result. The Wastewater District
14 produces and delivers effluent to golf courses and other customers using the plant in its
15 rate base. The Commission should establish an effluent rate to be billed and collected by
16 the Wastewater District and end the subsidy being provided by the customers of that
17 district.

18 **B. The Rate for Sewage Effluent Should Be \$250 an Acre-Foot.**

19 Prior to Decision No. 71410, the rate charged for effluent, as well as other types of
20 non-potable water (such as raw Central Arizona Project water), was \$202 per acre-foot
21 (\$0.62 per 1,000 gallons).¹⁹ That rate was consistent with the rate charged by other
22 private sewer utilities regulated by the Commission. For example, in Decision No. 71410,
23 the Commission authorized AAWC's Mohave Wastewater District to charge \$227 per

24 ¹⁷ Tr., Phase II, at 734 (testimony of RUCO witness Mr. Moore), 1192 (testimony of Staff witness
25 Mr. Michlik).

26 ¹⁸ *Id.* at 185, 187.

¹⁹ Kelly Dt. at 3-4, 5.

1 acre foot for sewage effluent.²⁰ As in this case, AAWC sells effluent to a golf course in
2 Mohave County, which is then reused for turf irrigation.²¹ AAWC's witness, Mr.
3 Broderick, testified that the rate which was proposed for the Mohave Wastewater District,
4 \$250 an acre-foot, is comparable to the rate charged by other effluent providers,
5 identifying two private sewer utilities, Woodruff Utility Company and Gold Canyon
6 Sewer Company, which sell effluent in Pinal County, and the City of Bullhead.²²

7 The prior effluent rate of \$202 per acre-foot in Verrado and the rate of \$227 per
8 acre-foot approved for AAWC's Mohave Wastewater District are comparable to the rates
9 charged by other sewer utilities regulated by the Commission. Attached to Mr. Kelly's
10 direct testimony as Exhibit DTK-2 is a table that lists the effluent rates for 12 private
11 sewer utilities, which range from a low of \$55 per acre-foot to a high of \$400 per acre-
12 foot. Notably, only three of the utilities have a rate that exceeds \$300 per acre-foot, and
13 of those three utilities, only one is greater than \$326 per acre-foot. Conversely, six of the
14 utilities have rates that are \$200 per acre-foot or less.

15 While Exhibit DTK-2 doesn't include every sewer utility in Arizona regulated by
16 the Commission, it certainly provides a representative cross-section of the rates being
17 charged for effluent. Moreover, AAWC provided no examples of sewer utilities that
18 charge substantially more for effluent. When cross-examined about whether he was
19 aware of any effluent rates omitted from Mr. Kelly's exhibit, the only omission Mr.
20 Broderick identified was the rate being charged by the Anthem Water District for non-
21 potable water.²³ However, the Anthem Water District's rate covers all types of non-
22

23 ²⁰ *Id.* at 4, Ex. DTK-1; Tr., Phase II, at 180.

24 ²¹ *Id.* See also Kelly Dt., Ex. DTK-1 at 32-33 (excerpt from Revised Direct Testimony of
25 Thomas M. Broderick; citing internal page numbers) (discussing the sale of effluent to Desert
Lakes Golf Course).

26 ²² Kelly Dt., Ex. DTK-1 at 33.

²³ Tr., Phase II, at 181-83.

1 potable water, including Colorado River water, and therefore is not a true effluent rate.²⁴
2 The bottom line is that \$250 per acre-foot is consistent with other Commission-approved
3 rates for effluent.

4 In addition, a rate of \$250 per acre-foot will encourage, rather than discourage,
5 effluent reuse for turf irrigation and other non-potable purposes in accordance with state
6 water policy. AAWC recognized the importance of setting a rate for effluent that
7 encourages its use in its prior rate case. Mr. Broderick explained that AAWC's proposed
8 rate of \$250 per acre-foot for effluent delivered by the Mohave Wastewater District
9 "would remain below the cost of water" being provided by the golf course's other water
10 provider. "Thus, as the Mohave Wastewater District's sewage flows grow the golf course
11 should continue to purchase all of the effluent produced."²⁵ Pricing effluent above the
12 cost of alternative water supplies will cause those less costly water supplies – which do
13 not present the same operational challenges as effluent (e.g., reuse permit standards and
14 requirements) – to be substituted for effluent.

15 In this case DMB has access to groundwater by means of a well and related
16 facilities that allow DMB to pump and deliver groundwater to the Raven Golf Club at a
17 cost that is approximately \$250 per acre-foot.²⁶ As Mr. Kelly explained, DMB would
18 prefer to use effluent (and untreated Central Arizona Project ("CAP") water²⁷) for golf
19 course irrigation and other non-potable uses in Verrado, and would purchase all of the
20

21 ²⁴ *Id.* at 182. The same anomaly that exists in Verrado also exists in Anthem, where effluent is
22 produced and delivered by the Wastewater District, but is billed by the Anthem Water District,
artificially increasing the rate for sewer service and lowering the rate for water service.

23 ²⁵ Kelly Dt., Ex. DTK-1 at 33.

24 ²⁶ *Id.* at 5; Tr., Phase II, at 705-06, 710-11.

25 ²⁷ AAWC also charges \$888 per acre foot for raw CAP water, even though the total cost to obtain
CAP water is approximately \$160 per acre foot. Kelly Dt. at 5-6, Ex. DTK-3. Thus, Arizona-
American charges more than five times the cost of obtaining raw CAP water for "non-potable"
water service in Verrado. This rate is also unreasonable and discourages the use of renewable
CAP water in lieu of groundwater, in contravention of state water policy.

1 effluent produced by the Wastewater District in Verrado if the price were reasonable.²⁸
2 Conversely, if the rate for effluent (and untreated CAP water) exceeds the cost of using
3 groundwater, DMB will maximize its groundwater use to reduce the cost of operating the
4 golf course.²⁹

5 Last month, the rate charged by the Agua Fria Water District for non-potable water
6 was reduced to \$404 per acre-foot (\$1.24 per 1,000 gallons).³⁰ Unfortunately, that rate is
7 still substantially greater than DMB's cost to use groundwater and, consequently, provides
8 no incentive to substitute effluent (or raw CAP water) for groundwater. Obviously, if
9 DMB can save nearly \$150 an acre-foot of water by using groundwater instead of reusing
10 effluent for golf course irrigation, DMB will be forced to use groundwater. Again, this is
11 not what DMB would prefer to do, and from a water policy perspective, it makes no
12 sense.

13 For example, Ms. Jerich, RUCO's Director, testified that one of the Commission's
14 primary goals in setting rates for water utilities is conservation.³¹ Thus, RUCO is
15 concerned that consolidation of AAWC's various water districts will distort the price
16 signals provided to customers, eliminating their economic incentive to "use their water
17 wisely."³² Ms. Jerich also testified at the hearing that effluent users should be given the
18 correct price signal:

19 Q. [by Mr. James] . . . Do you think it is preferable as a
20 matter of statewide water policy to encourage the use
of effluent for golf courses and other turf irrigation?

21 A. [by Ms. Jerich] Yes.

22 Q. And do you think that the rate for effluent should be

23 ²⁸ Kelly Dt. at 7; Tr., Phase II, at 706, 710-11, 720.

24 ²⁹ Kelly Dt. at 7; Tr., Phase II, at 705, 710-11

25 ³⁰ Procedural Order, Docket No. W-01303A-08-0227 (June 17, 2010).

26 ³¹ Jerich Rate Consol. Dt. at 14-15.

³² *Id.* at 14.

1 set at a level that encourages the use of effluent for turf
2 irrigation?

3 A. Yes.³³

4 Pricing effluent at a rate that is greater than the cost to use groundwater for turf irrigation
5 encourages non-potable water users to minimize effluent use and maximize groundwater
6 use. Obviously, this is wrong price signal to send customers if the Commission intends to
7 encourage effluent reuse.

8 AAWC has not offered any legitimate response to the foregoing. Even Mr.
9 Broderick conceded that it would be preferable to have DMB use all of the effluent
10 produced by the wastewater treatment plant in Verrado for turf irrigation.³⁴ Boiled down,
11 AAWC apparently contends that the rate for effluent should be higher than the cost of
12 alternative water supplies because water and wastewater rates are going up.³⁵ It also
13 believes that the rate proposed by Mr. Broderick in his rebuttal testimony – approximately
14 \$533 an acre-foot – constitutes “revenue concession” by the utility.³⁶ Presumably,
15 AAWC will contend in its closing brief that the Commission’s recent reduction in the rate
16 charged by the Agua Fria Water District for non-potable water is an even greater “revenue
17 concession.” That argument is misplaced for several reasons.

18 First, the Wastewater District has no rate for effluent in its tariffs. Thus, any
19 revenue produced by the sale of effluent, at the rate set by the Commission in this case,
20 will be additional revenue that the district is not currently collecting. As discussed in the
21 previous section of this brief, that revenue will lower the rates for sewer utility service in
22 Verrado and other portions of the Wastewater District’s service territory by properly
23 matching the revenue generated by the delivery of effluent to the utility plant and

24 ³³ Tr., Phase II, at 1175.

25 ³⁴ *Id.* at 189.

26 ³⁵ *Id.* 189-90

³⁶ *Id.* at 717 (cross-examination of Mr. Kelly by AAWC counsel).

1 operating expenses related to the collection and treatment of wastewater.

2 Second, as Mr. Kelly testified during the hearing, there is no “revenue concession”
3 if no one is purchasing the effluent because the rate for effluent exceeds the cost of
4 alternative water supplies, including groundwater.³⁷ Instead, AAWC loses revenue that it
5 otherwise would collect from the sale of effluent, causing the Wastewater District’s sewer
6 customers to pay higher rates. At the same time, groundwater will be used rather than
7 effluent for turf irrigation in contravention of state water policy.

8 Finally, if effluent cannot be sold because it is priced too high, AAWC will incur
9 additional operating expenses to dispose of the effluent. Effluent is a unique commodity.
10 When effluent is provided to golf courses for turf irrigation (thereby serving as a
11 substitute for other water supplies), the utility avoids the cost of having to dispose of the
12 effluent in accordance with the requirements imposed by the Clean Water Act and
13 Arizona law governing the discharge of pollutants, as Ms. Hains explained during the
14 hearing.³⁸ Thus, not only does the sale of effluent for reuse by DMB generate an
15 additional revenue stream for the Wastewater District, but it reduces the district’s
16 operating expenses while ensuring that the effluent will be disposed in accordance with
17 applicable regulatory standards.

18 For these reasons, it is largely irrelevant whether the overall cost of providing
19 utility service is increasing due to the addition of utility plant or increases in operating
20 expenses. Effluent is a by-product of the sewage collection and treatment process, and
21 will exist whether the effluent is sold to golf courses for reuse or is discharged into a
22 watercourse or an underground injection well. From a public policy standpoint, it is better
23 to sell the effluent to golf courses at a rate that encourages its reuse for turf irrigation,
24

25 ³⁷ *Id.* at 717, 719-20.

26 ³⁸ *See* Tr., Phase I, at 776-80 (discussing the various permits and other requirements relating to the disposal and reuse of effluent).

1 generating revenue in the process, rather than discharging the effluent into wash while the
2 golf courses pump groundwater to satisfy their water requirements. Therefore, AAWC's
3 position conflicts with public policy and, frankly, common sense, and should be rejected.

4 **C. Conclusion and Relief Requested.**

5 For the reasons set forth above, DMB submits that the Commission should
6 authorize a specific rate for the delivery of effluent by the Wastewater District and that
7 this rate should \$250 per acre-foot. Allowing the Agua Fria Water District to bill
8 customers for the delivery of effluent produced by the Wastewater District creates a
9 mismatch between rate base, operating expenses and revenues, violating basic rate-
10 making principles and forcing the Wastewater District's customers to subsidize the
11 customers of the Agua Fria Water District. A rate of \$250 per acre-foot will send a price
12 signal which encourages the use of effluent for turf irrigation in accordance with state
13 water policy, while providing AAWC with a low cost means of disposing of its effluent in
14 accordance with applicable environmental laws and agency requirements.

15 RESPECTFULLY SUBMITTED this 16th day of July, 2010.

16 FENNEMORE CRAIG, P.C.

17
18 By Norm D. James
19 Norman D. James (No. 006901)
20 3003 North Central Avenue
21 Suite 2600
22 Phoenix, Arizona 85012
23 Attorneys for DMB White Tank LLC

24 An original and 13 copies
25 of the foregoing was delivered this 16th
26 day of July, 2010, to:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

1 A copy of the foregoing
2 was delivered/mailed this 16th day of
3 July, 2010, to:
4 Teena Wolfe
5 Administrative Law Judge
6 Hearing Division
7 Arizona Corporation Commission
8 1200 W. Washington Street
9 Phoenix, AZ 85007
10 Thomas H. Campbell
11 Michael T. Hallam
12 Lewis and Roca LLP
13 40 N. Central Avenue, Suite 1900
14 Phoenix, AZ 85004
15 Attorneys for Arizona-American Water Co.
16 Steven M. Olea, Director
17 Utilities Division
18 Arizona Corporation Commission
19 1200 W. Washington St.
20 Phoenix, AZ 85007
21 Maureen Scott
22 Robin Mitchell
23 Legal Division
24 Arizona Corporation Commission
25 1200 W. Washington Street
26 Phoenix, AZ 85007
Judith M. Dworkin
Sacks Tierney PA
4250 N. Drinkwater Blvd., 4th Floor
Scottsdale, AZ 85251-3693
Attorneys for Anthem Community Council
Lawrence V. Robertson, Jr.
P.O. Box 1448
Tubac, AZ 85645-1448
Attorney for Anthem Community Council
Daniel Pozefsky
Residential Utility Consumer Office
1110 W. Washington St., Suite 220
Phoenix, AZ 85007
Larry Woods, President
Property Owners and Residents Association
13815 W. Camino Del Sol
Sun City West, AZ 85375

- 1 W.R. Hansen
12302 W. Swallow Drive
2 Sun City West, AZ 85375
- 3 Greg Patterson
916 W. Adams St., Suite 3
4 Phoenix, AZ 85007
Attorney for Water Utility Ass'n of Arizona
- 5 Jeff Crocket
6 Robert Metli
Snell & Wilmer
7 400 E. Van Buren Street
Phoenix, AZ 85004-2202
8 Attorneys for the Paradise Valley Resorts
- 9 Andrew M. Miller
Town of Paradise Valley
10 6401 E. Lincoln Drive
Paradise Valley, AZ 85253
- 11 Bradley J. Herrema
12 Robert J. Saperstein
Brownstein Hyatt Farber Schreck, LLP
13 21 E. Carillo St.
Santa Barbara, CA 93101
14 Attorney for Anthem Golf and Country Club
- 15 Marshall Magruder
P.O. Box 1267
16 Tubac, AZ 85646-1267
- 17 Larry D. Woods
15141 W. Horseman Lane
18 Sun City West, AZ 85375
- 19 Joan S. Burke
Law Office of Joan S. Burke
20 1650 N. First Avenue
Phoenix, AZ 85003
21 Attorney for Corte Bella Golf Club
- 22 Philip H. Cook
10122 W. Signal Butte Circle
23 Sun City, AZ 85373

24

25

26

1 Desi Howe
2 Anthem Golf and Country Club
3 2708 W. Anthem Club Drive
4 Anthem, AZ 85086

5 By: Mary Howe
6 2330167

7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
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